

1       **THE HONORABLE DAVID RUDER, FORMER CHAIRMAN, SECURITIES AND**  
2                                   **EXCHANGE COMMISSION**

3  
4               CHAIRMAN JAMES:    I'd like to begin with you, Mr.  
5 Ruder.

6               MR. RUDER:   Thank you very much, Dean James.   It is a  
7 pleasure to be here.

8               The securities markets and gambling share certain  
9 characteristics.   Both involve uncertainty regarding outcome.  
10 For a gambler this uncertainty is frequently quantified as the  
11 odds that their certain bet will be successful.   For an investor  
12 the uncertainty is whether the market will value the investment  
13 at a higher or lower level over time.   Thus, both investing and  
14 gambling involve risk.

15              The primary distinction between gambling, as Mr.  
16 Leone pointed out, and investing is that an investor purchases an  
17 ownership right in a document that has underlying value, such as  
18 stock, while gambling only involves the right to require another  
19 to meet an obligation to pay.   Both gambling and investing  
20 involve a variety of products.

21              Gambling may involve many different activities  
22 including card playing, dice throwing, horse racing, lottery.  
23 Investing may involve the purchase or sale of many different  
24 securities, stocks and bonds and more complicated derivative  
25 securities.

26              The Securities and Exchange Commission regulates  
27 investing.   It does so by regulating the distribution and trading  
28 of securities directly, and with the help of so called regulatory  
29 organizations, the stock exchanges and the National Association

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1 of Securities Dealers. The SEC oversees these SROs by approving  
2 their rules, inspecting them and occasionally imposing  
3 disciplinary sanctions on them.

4 The Securities Exchange Act of 1934 requires all  
5 brokers and dealers to register with the SEC and become members  
6 of the NASD or the Securities Exchange. The SEC then adopts  
7 rules, governing the conduct of brokers and their associated  
8 persons and the exchanges in the NASD also adopt rules relating  
9 to the conduct of their members.

10 Several aspects of the securities law regulating  
11 distribution of securities offer important insights for the  
12 gambling industry. When corporations sells securities to the  
13 public, they are asking investors to believe that future  
14 prospects for the corporation are good. The primary protection  
15 offered by the federal securities laws is disclosure, rather than  
16 evaluation of the merits of proposed investments. The theory is  
17 that once investors are fully informed, they should be able to  
18 bear the risks and reap the rewards of their investment  
19 judgments.

20 The primary device used by the SEC to assure fair  
21 disclosure is to require that corporations selling securities  
22 prepare and distribute a prospectus containing the disclosures.  
23 One of the disclosures involves risk factors involved in the  
24 offering. I might just read this regulation in part that governs  
25 this. It requires inclusion of the discussion of the principal  
26 factors that make the offering speculative or one of high risk.  
27 These factors may be due, among other things, to such matters as  
28 an absence of operating history of the registrant and the absence  
29 of profitable operation in recent periods, the nature of the

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1 business in which the registrant is engaged and proposes to  
2 engage or the absence of a previous market for the registrant's  
3 common equity.

4 I was not asked to make recommendations to you, but  
5 I'm going to do so anyway. I believe that the disclosure  
6 protection of the securities laws provide an excellent model for  
7 gambling. Those conducting gambling activities should be  
8 required to make adequate disclosures about the risks of  
9 gambling, including a general warning about the risks of gambling  
10 and specific disclosure of the odds applicable to each form of  
11 gambling.

12 A second area of protection involves investor  
13 sophistication. When corporations choose to sell securities  
14 without registering them, the SEC provides protections to those  
15 who are buying the securities. The assumption is that certain  
16 investors, called accredited investors, are sophisticated enough  
17 to seek ample disclosure before investing and sophisticated  
18 enough to understand the significance of information disclosed to  
19 them. Accredited investors are defined by the Securities and  
20 Exchange Commission to include officers and directors of the  
21 corporation whose securities are being offered, banks, natural  
22 persons with considerable wealth, net worth exceeding \$1 million.

23 However, in one of its exemptive rules, the SEC  
24 recognizes that persons who are not in this category, non  
25 accredited investors, may not be financially sophisticated and  
26 requires that each person who is not an accredited investor,  
27 either alone or with a purchaser representative, has such  
28 knowledge and expertise in financial and business matters that he

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1 is capable of evaluating the merits and risks of their  
2 perspective investment.

3 This emphasis upon the ability to understand risk  
4 also provides a good model for the gambling industry. Those who  
5 conduct these gambling activities should be prevented, in my  
6 opinion, from directing advertisements to persons who do not have  
7 the sophistication to understand gambling risks.

8 A third area of protection for investors is under the  
9 doctrine of suitability. The NASD requires their members and  
10 registered representatives to deal fairly with their customers  
11 and also requires that in making recommendations to a customer,  
12 the member must have reasonable grounds for believing that the  
13 recommendation is suitable for such customer and must make  
14 reasonable efforts to obtain information requiring the customer's  
15 financial status, tax status and investment objective. This  
16 suitability requirement is intended to prevent brokers from  
17 inducing their customers to purchase securities that are too  
18 risky for them.

19 Again, I think there's a parallel here that may be  
20 important in the gambling area. Consideration should be given to  
21 requiring gambling sponsors or entities attempting to persuade  
22 others to engage in gambling activities, to refrain from  
23 directing advertisements to potential gamblers who are unable to  
24 bear the financial risk of gambling losses.

25 There's a category of investing involving derivative  
26 instruments called options, a very complicated instrument. Here,  
27 when the risk is greater and the instruments are more  
28 complicated, the SEC and the options exchanges have more  
29 extensive disclosure requirements. The SEC requires options

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1 disclosures and as a result the options exchanges have prepared a  
2 disclosure document regarding risks of option holders and  
3 writers, risks of index options, risks of debt options, risks of  
4 foreign currency options, risks of flexibly structured options  
5 and other risks such as combination options. This booklet which  
6 is in Mr. Harris' exhibit called Characteristics and Risks of  
7 Standardized Options is a 95-page pamphlet containing 31 pages  
8 dealing with risks alone. It's intended to protect the investors  
9 who are involved with this complicated area of investing.

10 As noted, gambling and investing share several common  
11 elements. Both activities involve elements of risks that are not  
12 within the control of the participants. Gambling and investment  
13 products, by nature, require disclosure in order to be well  
14 understood. Persons engaged in gambling and investing will have  
15 varying degrees of financial sophistication and ability to bear  
16 the risk.

17 In conclusion, I would like to repeat my  
18 recommendations to you, which I may say are made by me in my  
19 personal capacity and not as a member or former member of the  
20 Securities and Exchange Commission, but they are heartfelt from  
21 my point of view.

22 At a minimum, those conducting gambling activities  
23 should be required to make adequate disclosures about the risks  
24 of gambling. Disclosure should include a general warning about  
25 the risks of gambling and specific disclosures of the odds  
26 applicable to each form of gambling. Those conducting gambling  
27 activities should be required to refrain from directing  
28 advertisements to prospective gamblers who do not have the

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1 financial sophistication necessary to understand the gambling  
2 risk and the financial ability to bear gambling losses.

3           We've seen hints of that with regard to tobacco  
4 advertising in this country and measures being considered in that  
5 industry. Third, although not a firm recommendation, I think  
6 consideration should be given to finding other ways to protect  
7 those who are either financially unsophisticated or unable to  
8 bear the risk of loss, such as by restricting access to gambling  
9 establishments or access to certain kinds of gambling. Thank  
10 you.

11           CHAIRMAN JAMES: Thank you.

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